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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of)
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Implementation of the Local)
Competition Provisions in the)
Telecommunications Act of 1996)
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_____)

CC Docket No. 96-98

To: The Commission

**PETITION FOR RECONSIDERATION OF
TIME WARNER COMMUNICATIONS HOLDINGS, INC.**

TIME WARNER COMMUNICATIONS HOLDINGS, INC.

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SUMMARY

Time Warner Communications Holdings, Inc. (TW Comm) petitions for reconsideration of the First Report and Order in this proceeding on the basis that the Commission's methodology for establishment of wholesale rates for incumbent local exchange carrier services provided to other carriers for resale violates the wholesale rate standard codified in the 1996 Act. Specifically, the Commission has improperly converted that "avoided cost" standard contained at Section 252(d)(3) of the Act into a "reasonably avoided costs" standard. The result of this conversion is to substantially increase the ILEC costs which are to be excluded from wholesale rates and to enlarge the rate discounts available to other carriers. This will promote inefficient market entry through resale in contravention of the Commission's stated intent not to base the wholesale pricing formula on policy grounds.

The avoided cost standard of Section 252(d)(3), if properly applied, would exclude from ILEC retail rates only those costs which are not incurred by ILECs in providing wholesale service to resellers. Instead, the Commission's rules will require ILEC wholesale rates to be based on costs that might be avoided or costs that could be avoided under various improbable hypothetical scenarios (*e.g.*, that ILECs will entirely abandon retail markets) and provide service only through resellers.

The Commission has identified certain accounts from the Uniform System of Accounts as being presumptively avoidable. However, analysis of those accounts leads to the conclusion that many of the costs contained therein would not be avoided by the Commission in serving wholesale customers, and therefore should not be excluded from retail rates under the statutory avoided cost standard. ILECs will continue to incur product management, sales, and advertising

expenses as well as administrative expenses comparable to those presently incurred in serving retail markets. Analogies to computer processing chips, as well as telecommunications access service and interexchange resale, demonstrates that such costs will continue to be incurred by ILECs in serving wholesale markets.

Because the standards mandated by the Commission for conducting avoided cost studies deviate from the statutory requirement, the prescribed default rate range of 17 to 25 percent -- based on those standards -- similarly will deviate from the avoided cost standard. Thus, the default rate either should be adjusted downward to levels consistent with actually avoided costs, or the default range should be abandoned altogether, requiring the states promptly to establish wholesale rates based on actually avoided costs.

Finally, by excluding the costs contained in the Call Completion Services and Number Services accounts from wholesale rates on the basis that resellers will provide those services themselves or contract for them separately, the Commission is sanctioning the availability of discounted ILEC services at wholesale rates which differ from the retail services provided by ILECs to end users, and the supplementing of those services by resellers with unbundled network elements. This ability to "mix and match" wholesale ILEC services for resale with unbundled network elements is not contemplated by the Act and should not be permitted by the Commission.

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**PETITION FOR RECONSIDERATION OF
TIME WARNER COMMUNICATIONS HOLDINGS, INC.**

Time Warner Communications Holdings, Inc. ("TW Comm"), by its attorneys, pursuant to Section 1.429 of the Commission's rules,¹ hereby petitions for reconsideration of the Commission's First Report and Order issued in this proceeding,² and states as follows:

Introduction

TW Comm generally concurs with the rules promulgated by the Commission in the First Report and Order and commends the Commission on its achievement of completing this proceeding within the six month period afforded it by Congress. In order to implement Sections 251 and 252 of the Telecommunications Act of 1996, the Commission had to address and resolve numerous and complex issues within an extremely brief time frame. TW Comm recognizes the unique challenge faced by the Commission and its staff in this docket and respects the

¹47 C.F.R. § 1.429.

²Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (First Report and Order), FCC 96-325, released August 8, 1996 ("First Report and Order").

comprehensive and carefully-reasoned analyses upon which the First Report and Order are based. By this petition, TW Comm asks the Commission to reconsider and revise only one aspect of the many rules and policies adopted therein. Specifically, it believes that the rules promulgated by the Commission for establishment of the wholesale rates to be charged by incumbent local exchange carriers ("ILECs") pursuant to Section 251(c)(4) of the Communications Act of 1934, as amended by the Telecommunications Act of 1996 ("Communications Act" or the "Act")³ must be modified so that the prices for wholesale services made available for resale conform with the statutory formula for wholesale rates codified at Section 252(d)(3) of the Act. As will be explained in this petition, by changing the standard for establishment of wholesale rates for purposes of resale from one based on "avoided costs" to one based on the Commission's perception of "reasonably avoidable costs," the Commission has substituted its judgment for that of Congress and has materially modified a critical provision of the 1996 Act. Moreover, in doing so, the Commission has mandated the availability to resale carriers of ILEC services at excessively discounted rates and has established a policy which will promote and nurture inefficient entry into the local exchange service marketplace in contravention of the intent of Congress in enacting the 1996 Act and in contravention of its own stated policy objectives.

TW Comm is committed to constructing and operating facilities-based competing local telecommunications networks. However, notwithstanding its commitment to development of facilities-based networks, TW Comm agrees that resale will be an important aspect of the

³Throughout this petition, the Telecommunications Act of 1996 shall be referred to as the "1996 Act."

development of local service competition. In seeking reconsideration of the resale provisions of the First Report and Order, TW Comm seeks only that the Commission remain faithful to the clear statutory directive and that it neither artificially stimulate nor artificially discourage use of resale as a means to enter local service markets.

I. The Statutory Scheme of the 1996 Act

Section 251 of the Communications Act, added to the Act by the 1996 Act, imposes an obligation on all ILECs to make their services available to other telecommunications carriers at wholesale rates. Specifically, Section 251(c)(4)(A) requires ILECs:

to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers;⁴

Section 252(d)(3) of the Act contains the statutory standard for establishment of wholesale prices for resold ILEC telecommunications services provided to telecommunications carriers pursuant to Section 251(c)(4). That provision states as follows:

For the purposes of Section 251(c)(4), a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.⁵

II. By Converting the Statutory "Avoided Cost" Standard to a "Reasonably Avoidable Cost" Standard, the Commission has Disregarded the Plain Meaning of the 1996 Act and Undermined Congressional Intent

As indicated by the statutory language of Section 252(d)(3) underscored above, wholesale

⁴47 U.S.C. § 251(c)(4)(A).

⁵47 U.S.C. § 252(d)(3) (emphasis added).

rates for services made available for resale shall be determined by state commissions based on retail rates excluding only the costs which will actually be avoided by ILECs in providing service to resellers rather than to retail customers (*i.e.*, end users). This is what Congress stated and, based upon the legislative history of the 1996 Act, is what Congress meant.⁶ Neither the statutory language itself nor the legislative history accompanying the 1996 Act suggests any ambivalence with regard to this provision.

Notwithstanding the clarity of Section 252(d)(3), the Commission, in the First Report and Order, has departed significantly from the avoided cost standard codified in that subsection. Rather than promulgating regulations to guide state commissions in implementing the avoided cost standard, the Commission has chosen to replace the avoided cost standard with something quite different -- a "reasonably avoidable cost" standard. In opting for a reasonably avoidable cost standard rather than the avoided cost standard as mandated by the Act, the Commission states as follows:

We find that "the portion [of the retail rate] . . . attributable to costs that will be avoided" includes all of the costs that the LEC incurs in maintaining a retail, as opposed to a wholesale, business. In other words, the avoided costs are those that an incumbent LEC would no longer incur if it were to cease retail operations and instead provide all of its services through resellers. Thus, we reject the arguments of incumbent LECs and others who maintain that the LEC must actually experience a reduction in its operating expenses for a cost to be considered "avoided" for purposes of Section 252(d)(3). We do not believe that Congress intended to allow incumbent LECs to sustain artificially high wholesale prices by declining to reduce their expenditures to the degree that certain

⁶See, *e.g.*, H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. at 126 (1996) "The wholesale rate for resold services under new section 251(c)(4) is to be determined by the State commission on the basis of the retail rate charged to subscribers of such telecommunications services, excluding costs that will be avoided by the incumbent carrier."

costs are readily avoidable. We therefore interpret the 1996 Act as requiring states to make an objective assessment of what costs are reasonably avoidable when a LEC sells its services wholesale.⁷

The language used by Congress in articulating the avoided cost requirement could not have been clearer. Costs that "will be avoided" does not mean costs that could be avoided; it does not mean costs that might be avoided in the highly unlikely event that ILECs were to exit the retail market and provide service only on a wholesale basis (*i.e.*, to resellers for resale to end users). Costs that "will be avoided" means only costs that will, in fact, be avoided (*i.e.*, not incurred) by ILECs when they sell services to resellers rather than to retail customers. Whether or not certain ILECs might choose not to reduce expenditures when serving wholesale rather than retail markets, nothing in the Act authorizes the Commission to convert the statutory avoided cost standard -- a standard based on facts (*i.e.*, identification of costs that will be avoided when serving wholesale rather than retail markets), into an avoidable cost standard -- a standard based on speculation and conjecture (*i.e.*, what costs the Commission or state commissions believe that an ILEC could be able to avoid or might be able to avoid when serving wholesale rather than retail markets).

By converting the statutory "avoided cost" standard into a "reasonably avoidable cost" standard, the Commission has established a mechanism for enlarging the costs to be backed out of retail prices in establishing wholesale rates, thereby increasing the discounts below retail prices which will be applicable to services provided to resellers. While such "beyond avoided cost" discounts may make resale increasingly attractive to some market entrants, it is not what is contemplated by the 1996 Act and is contrary to the Commission's own stated refusal to

⁷First Report and Order, *supra* at ¶ 911 (emphasis added).

utilize non-cost factors in establishing wholesale rates. As noted by the Commission, "[t]he language of Section 252(d)(3) makes no provision for selecting a wholesale rate on policy grounds."⁸ Despite that denial, that is precisely what the Commission has done in converting the statutory avoided cost standard into an avoidable cost standard. The economic effect of that conversion is to improperly inflate the size of the discounted wholesale rates for ILEC services to be resold, to artificially stimulate the demand for ILEC resale services, and to make investment in competing facilities-based networks disadvantageous relative to resale. At ¶ 923 of the First Report and Order, the Commission purports to reject the assertions of certain commenting parties that national wholesale discount rates should be established at levels sufficient to ensure that resale is a viable business.⁹ Despite that overt denial, the Commission's avoidable cost standard and the cost studies to implement that standard which the Commission has required to be used by state commissions in determining wholesale discount levels will produce wholesale discounts which will be well beyond avoided costs in conflict with the 1996 Act in order to "jump start" local competition. Such "greenhousing" of resale-based competition is antithetical to the plain language of the 1996 Act and the policy objectives underlying that Act.¹⁰

⁸*Id.* at ¶ 914.

⁹*Id.* at ¶ 923.

¹⁰The Commission's apparent willingness to deviate from the plain meaning of Section 252(d)(3) is surprising in light of the Commission's insistence in other contexts to adhere to the "plain language" of the 1996 Act. See, e.g., Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996 (Notice of Proposed Rulemaking), CC Docket No. 96-187, FCC 96-367, released September 6, 1996, at ¶ 18.

III. The Commission has Improperly Presumed Certain Accounts to be Avoidable in Establishing the Criteria for Avoidable Cost Studies

In formulating the rules to be followed by ILECs in performing avoidable cost studies, the Commission has utilized certain accounts from the Uniform System of Accounts for Telecommunications Companies codified at Part 32 of the Commission's Rules (USOA).¹¹ These include direct expense accounts identified at ¶ 917 of the First Report and Order and indirect expense accounts listed at ¶ 918. As described in the First Report and Order, certain identified accounts are presumed by the Commission to be avoidable assumedly on the theory that the costs contained in these accounts are not routinely expended by ILECs when serving resellers.¹² However, classification of the costs in these accounts as avoidable does not withstand analysis.

A. Direct Expense Accounts

The first presumptively avoidable account identified by the Commission is Account 6611 (Product Management). That account is defined in the Commission's rules as follows:

This account shall include the costs incurred in performing administrative activities related to marketing products and services. This includes competitive analysis, product and service identification and specification, test market planning, demand forecasting, product life cycle analysis, pricing analysis, and identification and establishment of distribution channels.¹³

Does the Commission seriously believe that none of the costs included in that category will be incurred by ILECs in a wholesale market? Certainly, demand for products and services

¹¹47 U.S.C. Part 32.

¹²See, e.g., First Report and Order, *supra* at §§ 917-918.

¹³47 C.F.R. § 32.6611.

must be forecast by providers whether the product or service is to be sold in a wholesale or a retail market. Such demand forecasting is necessary to enable the ILEC to provision sufficient facilities in order to meet service needs, whether or not those needs are to be met by the ILECs directly or by the ILECs indirectly through resellers. Undoubtedly, each ILEC service is subject to a life cycle, even if it is to be sold through resellers. Similarly, ILEC services must be properly priced whether sold at wholesale or resale. There must be distribution channels in place for wholesale services as there are for retail services. While distribution channels for ILEC wholesale services may differ from those used to market or distribute ILEC retail services, they nonetheless will exist, and they impose costs on the ILEC -- costs which are neither avoided nor are reasonably avoidable in providing service to wholesale markets. In virtually any product or service market, these functions must be performed by manufacturers and service providers whether or not they deal directly with retail consumers. Thus, the costs included in Account 6611 should not be presumed to be reasonably avoidable.

The next account identified by the Commission as presumptively avoidable in a wholesale market is Account 6612 (Sales). The Commission's rules define that account as follows:

This account shall include costs incurred in selling products and services. This includes determinations of individual customer needs, development and presentation of customer proposals, sales order preparation and handling, and preparation of sales records.¹⁴

While it may be correct that the costs incurred in selling products and services might be somewhat lower in a wholesale market than they are in a retail market, it does not follow that the entirety of the account is presumptively avoidable, or that only ten percent of the costs

¹⁴47 C.F.R. § 32.6612.

contained in this account should be included in establishing the default rates based on the avoidable cost standard.¹⁵ ILECs will incur costs, indeed significant costs, in selling their services to resellers. Sales will have to be handled individually and will require substantial resources.

That costs associated with ILEC sales to resellers will be substantial, and not largely avoidable, can be concluded through analogy to an existing ILEC "wholesale" market -- the access service market. Since 1984, ILECs have provided local origination and termination of interexchange traffic by the sale of access services to interexchange carriers (IXCs). IXCs acquire access services from ILECs (and occasionally other access service providers) and resell those services to end user customers as part of their interexchange service offerings. Although ILECs do not normally sell access services to end users directly, they incur substantial expenses in selling those services to IXCs. In order to service that IXC market (which is, in fact, a wholesale market), ILECs establish marketing and account teams for their IXC customers, they establish sales order preparation, handling and sales record keeping functions to support those sales activities. Contrary to the Commission's unsupported conclusion, these sales-related costs are not shed, nor even significantly reduced, by selling in wholesale markets.

Account 6613 (Product Advertising) also is included in the Commission's list of presumptively avoidable costs. That account is defined in the Commission's rules as follows:

This account shall include costs incurred in developing and implementing promotional strategies to stimulate the purchase of products and services. This excludes nonproduct-related advertising, such as corporate image, stock and bond issue and employment advertisements, which shall be included in the

¹⁵First Report and Order, *supra* at ¶ 928.

appropriate functional accounts.¹⁶

It is incorrect for the Commission to presume that all -- or even ninety percent -- of ILEC product advertising costs would be avoided by selling in wholesale markets rather than retail markets. Of course, in the current environment, much of ILEC advertising is directed at retail end users. However, that does not mean that if ILECs abandoned retail markets in favor of wholesale (resale) markets, they no longer would incur advertising expenses. They would continue to do so even though the focus of their advertising would be directed differently than it is today. In a wholesale market, ILEC product advertising would be directed at resellers rather than end users. This means that the advertising would be in different media and would contain different messages. Nonetheless, advertising would remain necessary to stimulate demand for ILEC products and services. Stated simply, consumers must be persuaded that they need or want those services whether they are to obtain those services directly from the ILEC or indirectly from an ILEC through an ILEC reseller. So long as that is so, it will remain necessary for ILECs to advertise and to incur advertising costs in order to stimulate sales of their services.

The continued need for ILECs to engage in product advertising when they sell in wholesale markets is demonstrated by two analogous examples. First, in the computer industry, a company named Intel is the leading manufacturer of pentium processor chips. Intel does not sell pentium chips in a retail market to end users. It sells chips in a wholesale market to computer manufacturers who install Intel chips in their computers and "resell" them to end users in a retail computer market. Under the Commission's "reasonably avoidable cost" theory, Intel

¹⁶47 U.S.C. § 32.6613.

would avoid incurring advertising expenses since the advertising would be undertaken by the retailers (*e.g.*, IBM, NEC, Packard Bell, Apple, etc.) rather than by Intel. Yet, Intel engages in extensive advertising -- on television as well as in print media, to promote sale and usage of their pentium chips. Despite selling virtually all of its products in a wholesale market, Intel has not avoided advertising (or other sales and marketing) costs.

The second analogous example involves the telecommunications industry, specifically the competitive resale interexchange industry. During the past decade, there has been a proliferation of carriers which provide service to retail end user customers solely by reselling the services of one or more well-known facilities-based underlying carriers. Often, these resellers have no facilities of their own -- not even switches, and are frequently referred to as "switchless resellers" or as "rebillers." Many switchless resellers or rebillers entered the market and prospered by persuading their customers that the customers could utilize the services of their preferred network operators (most often AT&T) at more favorable rates than the customers could obtain from those network providers on their own. In short, switchless resellers and rebillers are dependent on AT&T's name recognition and standing in the end user market and AT&T continues to benefit from consumer desire for services provisioned by AT&T on the AT&T network, even when those services are provided through resellers or rebillers. It therefore remains necessary for AT&T to advertise in order to protect its product and service images, despite the fact that many consumers choose to use AT&T services acquired not from AT&T directly, but through resellers and rebillers who acquire service directly from AT&T in a wholesale market.

As the market for facilities-based local services becomes competitive, it will become

increasingly necessary for ILECs to advertise in order to promote and protect the perception of their services, despite the fact that many consumers may be acquiring those ILEC products and services through resellers. Just as the development of a wholesale (resale) market has not reduced AT&T's sales, marketing and advertising expenses, neither should it be presumed to reduce ILECs' sales, marketing and advertising expenses. Therefore, these costs will not be entirely or even largely avoided if and when ILECs provide portions of their service through resellers.

Account 6623 (Customer Services) also is listed among the accounts determined by the Commission to be presumptively avoidable. That account includes the costs of many of the functions associated with providing service to customers including, for example, initiating service orders, maintenance of billing accounts, collecting and investigating customer accounts, and instructing customers on use of products and services. Also included in this account are the costs of billing and collection services provided to interexchange carriers and other local exchange carriers.¹⁷ Contrary to the Commission's assumption, ILECs do not avoid these billing and collection costs when they provide service to wholesale customers rather than retail customers. Indeed, they incur substantial billing and collection costs in serving wholesale markets. For example, in the access services market, the ILECs have established and maintain complex and sophisticated systems for the billing and collection of access services (*e.g.*, the Carrier Access Billing System or "CABS"). There is no basis for concluding, as the Commission has concluded in the First Report and Order, that these costs would be shed by ILECs serving wholesale rather than retail customers. That conclusion disregards the manner

¹⁷47 C.F.R. § 32.6623.

in which ILECs serve customers --retail or wholesale. In order to provide service to wholesale customers for eventual resale to end users, ILECs must have mechanisms in place for initiating orders, for billing and collecting, for instructing customers in use of products or services.¹⁸

The costs contained in Accounts 6621 (Call Completion Services) and 6622 (Number Services) also are deemed by the Commission to be presumptively avoidable.¹⁹ Account 6621 includes the following:

. . . costs incurred in helping customers place and complete calls, except directory assistance. This includes handling and recording; intercept; quoting rates; time and charges; and all other activities involved in the manual handling of calls.²⁰

Account 6622 covers the following costs:

This amount shall include costs incurred in providing customer number and classified listings. This includes preparing or purchasing, compiling, and disseminating those listings through directory assistance or other means.²¹

The Commission's stated basis for presuming those cost accounts to be avoidable is that resellers either will provide those services themselves or will contract for them separately from

¹⁸It would be the responsibility of a reseller to instruct its customers how to use products and services purchased from that reseller. However, it would remain the responsibility of the ILEC to instruct the reseller how to use the products and services to be resold, so that they, in turn, may so instruct end users. This instruction, and the costs associated with the instruction, will be especially important for some of the "vertical" services with which many consumers are not yet familiar. Examples of such services include, but are not limited to, Caller ID, call waiting, third party calling, automatic return call, etc.

¹⁹First Report and Order, *supra* at ¶ 917.

²⁰47 C.F.R. § 32.6621.

²¹47 C.F.R. § 32.6622.

the ILEC or from third parties.²² As will be discussed more fully in Section V of this petition, the 1996 Act does not contemplate allowing carriers, including resellers, to modify the retail services provided by ILECs when they purchase those services at wholesale rates for resale. In certain jurisdictions, services whose costs are included in Accounts 6621 and 6622 are provided by ILECs to end users on an unbundled basis, *i.e.*, they are not included within the ILECs' rates for basic local service. Where such services (e.g., directory assistance, intercept, white pages listings, etc.) are not included within the rates for local service, they are not avoided costs in providing local service on a wholesale basis and should not be excluded from the rates charged to resellers.

B. Indirect Expense Accounts

The Commission presumes the General Support Expenses (accounts 6121-6124), Corporate Operations Expenses (accounts 6711, 6712, 6721-28) and Telecommunications Uncollectibles (account 5301) will be avoided by ILECs in proportion to the avoided direct expenses in the accounts noted above. There is no support for that presumption. Moreover, that presumption seems to be built upon a fiction created by the Commission. The fiction is that ILECs would totally abandon the retail market and provide only wholesale service to resellers.

As stated by the Commission:

Expenses recorded in these accounts are tied to the overall level of operations in which an incumbent LEC engages. Because the advent of wholesale operations will reduce the overall level of operations -- for example, staffing should decrease because customer inquiries and billing and collection activity will decrease

²²First Report and Order, *supra* at ¶ 917.

-- overhead and support are in part avoided.²³

There are several errors in this rationale. First, it assumes that ILECs will entirely abandon serving retail customers and entirely shed all costs incurred in serving those customers. Even if ILECs lose portions of their retail markets to resellers, it is improbable that they will totally exit those retail markets. They will continue to serve retail customers and will continue to incur costs of serving those customers -- some of which will not decline with reductions in the size of their retail businesses. Second, it assumes that these costs correlate directly and exclusively with the size of the ILECs' retail businesses. That will not be so for many of their overhead or general support accounts referenced at ¶ 918 of the First Report and Order.

Account 6121 (land and building expense) includes expenses associated with land and buildings (*e.g.*, janitorial service, cleaning, water, sewage, fuel, guard service, and electrical power).²⁴ These costs will remain largely the same whether or not ILECs provide service on a retail or a wholesale basis. There is no basis for presuming that reduction in ILEC retail operations and corresponding increases in wholesale operations will cause it to abandon buildings, nor will such changes reduce the price of cleaning supplies, electrical power, water, sewage, or guard service for those buildings. Thus, any significant reduction in ILEC land and building expenses seems improbable and should not be presumed.

Accounts 6122 (furniture and artworks expense), 6123 (office equipment expense) and 6124 (general purpose computers expense) similarly should not be significantly affected by whether or not ILECs reduce their retail operations and increase their wholesale operations.

²³*Id.* at ¶ 918.

²⁴47 C.F.R. § 32.6721.

The corporate operations accounts identified by the Commission as being subject to cost avoidance include Accounts 6711 (executive), 6712 (planning), 6721 (accounting and finance), 6722 (external relations), 6723 (human resources), 6724 (information management), 6725 (legal), 6726 (procurement), 6727 (research and development), and 6728 (other general and administrative). For the Commission to conclude that the costs in these accounts will be avoided in proportion to the avoidance of the direct expenses noted in the preceding section, there must be a basis for determining that ILECs would incur less expense in each of the categories by serving wholesale customers than they incur when they serve retail customers. Such a conclusion is unsupported and insupportable.

Will the ILECs reduce the number of executives or reduce those executives' salaries as a result of serving wholesale markets? Will their accounting or planning functions -- and associated costs -- be reduced? Will their legal and regulatory (external relations) costs shrink as a result of selling products to resellers?²⁵ Probably not. In the absence of any factual support for the proposition that the ILECs will in fact experience such reductions to these overhead expenses, the Commission should not have classified these costs as presumptively avoided.

The final account identified by the Commission as being presumed to be avoided in proportion to avoided direct expenses is Account 5301 (Uncollectible Revenue). Apparently, the Commission is of the opinion that ILEC uncollectibles will be reduced by serving wholesale

²⁵As the Commission is well aware, legal disputes between facilities-based interexchange carriers and resellers have been numerous and protracted, both before the Commission and in various courts. Based upon that experience, it is probable that the relationships between ILECs and their resale customers will be similarly acrimonious and will often result in litigation. Thus, legal and regulatory costs may increase as ILECs begin to serve resale customers.

customers. The First Report and Order contains no explanation for this conclusion. Not only is this assertion entirely unexplained and unsupported, it is counterintuitive. Given the nascency of the local service resale market, the competitiveness of that market and the uncertainty of the ability of resellers to pay their invoices to their ILEC wholesalers on a timely basis, it is at this time unknown whether ILEC uncollectibles will increase or decrease in wholesale markets. It is known based upon the many disputes between ILECs and access service customers and between facilities-based underlying interexchange carriers and interexchange resellers that some reseller accounts result in uncollectibles to the underlying carriers. Thus, there is no basis to presume that uncollectible expenses will be avoided by ILEC in proportion to avoided direct expenses.

IV. The Default Range of Wholesale Rates Established is Arbitrary and Not Based on the Record

In addition to articulating a "reasonably avoided cost" standard to be followed by state commissions in establishing wholesale ILEC rates, the First Report and Order establishes a "default" range of wholesale discounts of 17 - 25 percent to be used by state commissions pending completion of avoided cost studies using the methodology prescribed by the Commission.²⁶ The "basis" for that default range seems to be 1) an avoided cost model submitted by MCI as adjusted by the Commission, and 2) the results of several state proceedings where discount ranges have been established, as well as the Commission's own determinations as to which cost accounts are "reasonably avoidable."²⁷

²⁶First Report and Order, *supra* at ¶ 932.

²⁷*Id.* at ¶ 933.

TW Comm believes that this default range is excessive and unsupported. As described in this petition, the method established by the Commission for conducting avoided cost studies is flawed, and will produce wholesale rate discount levels which far exceed the costs which will be avoided by ILECs in serving wholesale customers. Since it appears that the default rate range established by the Commission (17 to 25 percent) is bottomed upon that flawed methodology, it is unsupported and should be eliminated.

Although the First Report and Order indicates that the default range is to be used by the states on an interim basis only pending completion of avoided cost studies, TW Comm fears that this range will become the *de facto* range for wholesale rates. Accordingly, TW Comm urges the Commission to adjust downward the default range to levels which conform with reasonable approximations of costs which actually will be avoided by ILECs in serving wholesale customers. Alternatively, TW Comm recommends that the Commission reconsider the wisdom of prescribing any interim default rates, and that it instead leave to the state commissions determinations of wholesale rates based upon actually avoided costs.

V. The First Report and Order Improperly Allows
Resellers to Modify ILEC Retail Service Offerings
by Modifying those Services with Unbundled Network Elements

As indicated in the preceding sections of this petition, the First Report and Order violates the 1996 Act by improperly converting the statutory avoided cost standard of Section 252(d)(3) into a reasonably avoidable cost standard and, in doing so, unlawfully inflating the discount levels on services to be provided by ILECs to telecommunications carriers for resale at wholesale rates. The First Report and Order violates the Act in another important respect. Its treatment of the costs contained in Accounts 6621 (Call Completion Services) and 6622 (Number

Services) will result in resellers becoming able to modify the retail services available at wholesale rates.

As indicated at Section III of this petition, the Commission has explained presuming those cost accounts to be avoidable on the basis that resellers either will provide those services themselves or will contract for them separately from the ILEC or from third parties.²⁸ This conclusion overlooks an important fact. By stating that these costs associated with ILEC retail services will be "avoided" on the basis that resellers -- unlike retail customers -- will either provide those service elements themselves or procure them from other sources, the First Report and Order seems to hold that wholesale customers (*i.e.*, resellers) will be able to obtain from ILECs retail services with fewer functionalities than when those services are provided to end user retail customers. The concept of resale service codified at Section 251(c) is that telecommunications carriers should be able to obtain from ILECs at wholesale rates "any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers."²⁹ The underscored language is critical. Inclusion of the key words "any telecommunications service" articulates Congress' intent that resellers should be allowed to purchase from ILECs at wholesale rates the same services that the ILECs provide at retail rates to end users. It does not mean that resellers should be able to purchase from ILECs discounted wholesale services which differ from retail services by their exclusion of certain service elements and functionalities. Yet, that would be the effect of the First Report and Order's treatment of the costs contained in Accounts 6621 and 6622.

²⁸First Report and Order, *supra* at ¶ 917.

²⁹47 U.S.C. § 251(c)(4)(A) (emphasis added).

In many jurisdictions, all, or at least some, of the service components whose costs are included in Accounts 6621 and 6622 are provided by ILECs to retail end users as part of local exchange service (*e.g.*, local directory assistance, white pages listings). Where those service components are provided on a bundled basis by ILECs to retail customers, that is the manner in which those ILEC services are to be provided to wholesale customers as well. By allowing wholesale customers to pay discounted rates further reduced by the customer's election to exclude certain elements of the services being purchased for resale, the Commission is altering the concept of resale codified at Section 251(c).

Rather than requiring that those functionalities be included in retail services when provided to other carriers at wholesale rates, the First Report and Order provides that the facilities and functionalities of providing operator services and directory assistance must be unbundled from the resold services and other network elements.³⁰ The net result of 1) allowing retail services to be modified by resellers to exclude those service components which are included when those services are provided to retail customers, and 2) holding that those functionalities may be obtained as unbundled network elements, the Commission has created a situation where resellers will be able to create hybrid services comprised of "stripped down" versions of the retail services provided to end users customized by selection of certain components of those retail services from the menu of unbundled network elements.

This ability to "mix and match" wholesale service with unbundled network elements is not what is contemplated by the Act. In fashioning the ILEC obligation to make available to other carriers retail services at wholesale rates and the separate ILEC obligation to allow other

³⁰First Report and Order, *supra* at ¶ 536.

carriers to purchase unbundled network elements, Congress afforded competitors choices of market entry strategies. These choices include resale and creation of new services composed of ILEC unbundled network elements. If a new entrant wishes to provide service by purchasing ILEC retail service at wholesale (based on avoided costs) and reselling that ILEC service to customers, the Act allows it to do so. If a new entrant wishes to provide service by purchasing unbundled network elements and to construct its own service to be provided to its customers, the Act allows it to do so.³¹ However, nothing in the 1996 Act or in its legislative history indicates any intent that new entrants should be permitted to obtain at wholesale rates ILEC services which differ from those available to the ILEC's customers who are not telecommunications carriers.

On reconsideration, the Commission should clarify, first, that the ILEC services available at wholesale rates may not differ from the services provided at retail rates to customers who are not telecommunications carriers. Second, it should also state that where service elements whose costs are contained in Accounts 6621 and 6622 are included in services provided to wholesale customers, so should those costs be included. For example, Account 6622 includes costs incurred in providing customer number and classified listing (*i.e.*, white pages directories). Unless ILECs exclude from their white pages directories telephone numbers assigned to customers of resellers, they will incur the customer number and classified listing costs whether service is provided by the ILECs to end users directly on a retail basis, or indirectly through a reseller. In such circumstances, the wholesale rates charged to resellers should include the

³¹Unbundled network elements are to be priced at levels to recover the ILECs' Total Element Long Run Incremental Cost (TELRIC) plus a reasonable share of joint and common costs. First Report and Order, *supra* at ¶¶ 674-703.